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Testimony of

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on behalf of
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House Committee on the Judiciary

Hearing on
"Exploring Alternative Solutions on the Internet Sales Tax Issue"

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Mr. Chairman, Ranking Member Conyers, and Members of the Committee, my name is Will Moschella,[1] and I appreciate the invitation to testify today as you continue to explore ways in which Congress can assist states collect sales and use taxes that are due under current state law.

We represent Simon Property Group, the largest owner/operator of shopping malls in the United States with 351 properties in 38 states and Puerto Rico. Over 420,000 employees work at Simon Property shopping malls and Simon tenants remit $4.6 billion in sales taxes and $608 million in property taxes to support the local economies where Simon properties are located. It is the firm opinion of David Simon, CEO of Simon Property Group, that congressional inaction on this issue will cause a serious downturn in the U.S. economy and that it is of tantamount importance to find a solution that can pass the Congress and be signed into law. He believes that there must be a level playing field regarding the tax treatment of internet sales and brick-and-mortar sales. The current situation; in his opinion, is absolutely untenable and Congress must enact a remedy.

The Simon Property Group fully supports the Marketplace Fairness Act as passed by the Senate. Simon Property is a member of the Marketplace Fairness Coalition, the International Council of Shopping Centers, and the National Association of Real Estate Investment Trusts, all of which support the Marketplace Fairness Act. The Marketplace Fairness Act is a well-considered, bipartisan proposal which enjoys the support of a wide coalition, including Governors, brick-and-mortar retailers, and Internet-based retailers. However, when Chairman Goodlatte indicated concerns with the Senate-passed version of the Marketplace Fairness Act, Simon Property endeavored to find other approaches that could address those concerns and still achieve the fundamental purpose of the Marketplace Fairness Act. If other effective ways to address the inequity in the current system can be supported by the vast stakeholders in this matter, Simon Properties will help lead the effort to forge consensus and move it forward. We offer our idea to be constructive and to assist the Committee as it considers remedies for what most agree is a problem that must be solved. In that spirit, Simon thanks the Chairman for calling this hearing to explore alternatives, and we are pleased to discuss an idea we think could satisfy the principles the Chairman released in 2013.

Injunctive Relief for Failure to Comply with State Sales Tax Laws

At its core, the Marketplace Fairness Act would authorize states to require remote sellers to collect and remit states sales taxes to the state to which goods are sent. Such legislation is needed because the Supreme Court has interpreted the Commerce Clause to prevent states from doing this on their own.

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[1] Mr. Moschella is a Shareholder at Brownstein Hyatt Farber Schreck LLP. Before joining the firm in 2008, Mr. Moschella served at the Department of Justice as the Principal Associate Deputy Attorney General and Assistant Attorney General for DoJ's Office of Legislative Affairs. Prior to that, he served in a number of capacities on Capitol Hill, including as the Chief Legislative Counsel and Parliamentarian of the House Committee on the Judiciary.

Another option would be to enact a federal law pursuant to Congress' Commerce Clause jurisdiction prohibiting the shipment of goods in violation of the sales tax laws of the state to which the goods are shipped. This is very similar to what Congress did in the 1913 Webb-Kenyon Act concerning the regulation and taxation of intoxicating liquors. In 2000, Congress reaffirmed and strengthened Webb-Kenyon by enacting an enforcement provision giving states the ability to seek injunctive relief in federal court for violations of Webb-Kenyon, including the failure of remote sellers of intoxicating liquors to collect state sales and excise taxes.

The Webb-Kenyon model is simple: it authorizes no new taxes; it recognizes the sovereign nature of state taxing decisions; it would not allow discriminatory sales taxes; and it should be politically acceptable because the Webb-Kenyon enforcement amendments garnered the support of this Committee and 310 Aye votes in the House of Representatives on August 3, 1999.

A brief review of the Webb-Kenyon Act and related Commerce Clause jurisprudence regarding the regulation of intoxicating liquors demonstrates how this model could apply to remote Internet sales.

Brief History of the Webb-Kenyon Act

Today, most regulation of alcohol occurs at the state level; however, state regulation of alcohol has not always been the norm in the U.S.[2] The ability of states to regulate alcohol has change as the Supreme Court's Commerce Clause jurisprudence has developed over the years and as Congress has responded to those changes.[3] For example, in the mid-19th century, states were understood to enjoy broad authority to regulate alcohol based on a series of highly contested cases in which the Supreme Court held that, unless there was a federal statute to the contrary, states were not constrained from what we refer to today as dormant or negative commerce clause restrictions.[4]

The temperance movement successfully sought to curb the sale and distribution of alcoholic beverages one state at a time. However, by the 1880's and 1890's, the Supreme Court became less accepting of state laws targeting imports. During this time, the Supreme Court began to recognize the implied restrictions inherent in the Commerce Clause; i.e. the dormant Commerce Clause restrictions on state action that discriminate against out-of-state products.[5]

Furthermore, and more instructive to today's topic, the Court held that the Commerce Clause prevented states from passing facially neutral laws that placed an

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[2] A complete explanation of this fascinating history is recounted in *Granholm. v. Heald*, 544 U.S. 460, 476 - 485 (2005).

[3] *See Castlewood Int'l Corp. v. Simon*, 596 F.2d 638, 641 (5th Cir. 1979) ("Since the founding of our Republic, power over regulation of liquor has ebbed and flowed between the federal government and the states.")

[4] *The License Cases*, 46 U.S. (5 How.) 504, 579 (1947).

[5] *Walling v. Michigan*, 116 U.S. 446 (1886) (invalidating a Michigan tax that burdened only liquor imports).

impermissible burden on interstate commerce.[6] For example, the Supreme Court in *Bowman v. Chicago & Northwestern Rail Co.* invalidated an Iowa statute requiring all liquor importers to have a permit.[7] In *Leisy v. Hardin*,[8] the Supreme Court held that, notwithstanding the fact that the statute in question did not discriminate against out-of-state sellers, Iowa could not prevent the importation of beer "until it became comingled in the common mass of property within the State. Up to that point of time," the Court reasoned, "in the absence of congressional permission to do so, the State had no power to interfere by seizure, or any other action, in prohibition of importation and sale by the foreign or non-resident importer."[9]

Because the Commerce Clause pendulum had swung so far away from the doctrine annunciated in *The License Cases*, the temperance movement took its case to the U.S. Congress. To address *Bowman* and *Leisy*, Congress enacted the Wilson Act which empowered the states to regulate imported liquor "to the same extent and in the same manner as though such liquids or liquors had been produced in such State or Territory . . . ."[10]

The Wilson Act was challenged under a number of legal theories. In response to a Commerce Clause challenge, the Supreme Court avoided the constitutional issue by construing the Act narrowly, holding that the Act did not permit states to regulate alcoholic beverages shipped in interstate commerce for personal use,[11] which many viewed as a direct-shipment loophole.

In order to close this direct-shipment loophole, in 1913 Congress enacted the Webb-Kenyon Act[12] over President Taft's veto.[13] The Supreme Court held Webb-Kenyon to be constitutional and observed that the Act prevented "the immunity characteristic of interstate commerce from being used to permit the receipt of liquor through such commerce in States contrary to their laws, and thus in effect afford a means by subterfuge and indirection to set such laws at naught."[14]

In the same way that the Webb-Kenyon Act eliminated the regulatory advantage obtained through the "immunity characteristic" of the Commerce Clause, today this Committee and Congress are considering ways to eliminate the regulatory advantage

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[6] *Granholm* at 476-477 (citations omitted).
[7] 125 U.S. 465 (1888).
[8] 135 U.S. 100 (1890).
[9] *Id* at 124-125. It should be noted that "Bowman and its progeny rested in part on the since rejected original-package doctrine. Under this doctrine goods shipped in interstate commerce were immune from state regulation while in their original package." *Granholm* at 477.
[10] 27 U.S.C. § 121.
[11] *Rhodes v. Iowa*, 170 U.S. 412, 421 (1898).
[12] 27 U.S.C., §122.
[13] Interestingly, President Taft vetoed Webb-Kenyon based on Attorney General Wickersham advice that "any law authorizing the States to regulate direct shipments for personal use would be an unlawful delegation of Congress' Commerce Clause powers." *Granholm* at 481.
[14] *Clark Distilling Co. V. Western Maryland R. Co*, 242 U.S. 311, 324 (1917).

enjoyed by remote sellers under contemporary Commerce Clause jurisprudence to avoid adhering to state tax law.

Some may argue that the Webb-Kenyon model is an inapt solution to the collection of state sales taxes by remote sellers because alcohol is "different" due to the history of state regulation and because the 21st Amendment repealed the 18th Amendment (Prohibition) and vested in the states the ability to regulate alcohol.

As already demonstrated, however, alcohol has not always been regulated at the state level, and at times in our history, states could not even regulate alcohol "in its original packaging" because that was understood to mean that the alcohol was still in interstate commerce and not subject to state regulation, including taxation. A strong argument could be made that the only reason alcohol is treated differently is because a powerful political movement – the temperance movement – had great support in Congress and across the nation.

Second, it would be incorrect to argue that Section 2 of the Twenty-first Amendment, which authorizes states to regulate alcohol, sets alcohol apart from other goods. The Supreme Court has noted that § 2 of the Twenty-first amendment expresses "the framers' clear intention of constitutionalizing the Commerce Clause framework established under [the Wilson and Webb-Kenyon Acts]."[15] In other words, the goals of section 2 of the Twenty-first Amendment had already been achieved by Congress in enacting Webb-Kenyon. Webb-Kenyon was a valid exercise of Congress' Commerce Clause authority. Furthermore, contemporary § 2 cases have found that the Twenty-first Amendment will not save "state laws that violate other provisions of the constitution"; "§ 2 does not abrogate Congress' Commerce Clause powers with regard to liquor"; and "state regulation of alcohol is limited by the nondiscrimination principle of the Commerce Clause." [16] In sum, § 2 did not expand states' authority beyond that which they already enjoyed under Webb-Kenyon.[17] Congress can exercise the same authority with regard to all goods subject to state tax laws.[18]

Congress Reaffirms and Enhances Webb-Kenyon in 2000

In 2000, Congress enacted the Twenty-first Amendment Enforcement Act ("Enforcement Act"), which amended Webb-Kenyon to provide states a means of enforcement (injunctive relief) when a state attorney general "has reasonable cause to believe that a person is engaged in, or has engaged in, any act that would constitute a violation of a State law regulating the importation or transportation of any intoxicating

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[15] 429 U.S. 190, 205-206 (1976) (footnote omitted). *See also, Florida Depatment of Business Regulation v. Zachy's Wine & Liquors, Inc.*, 125 F.3d 1399, 1402 (1997) ("In addition to repealing prohibition, the Twenty-first Amendment in effect constitutionalizes the Webb-Kenyon Act.").

[16] *Granholm* at 486-487.

[17] Congress reenacted Webb-Kenyon in 1935 after the ratification of the 21st Amendment.

[18] *Quill Corp. v. North Dakota*, 504 U.S. 298, 318 (1992)

liquor. . . ."[19] Congress took this action because direct shipments of alcohol in contravention of state law was a growing problem. The House Committee on the Judiciary's report on the bill observed that "several new players have entered the alcoholic beverage industry" and noted that "[w]ith the advent of the Internet, they have been able to advertise their product nationally and have been able to widely expand their market access." [20] The Committee report makes clear that the absence of an enforcement mechanism will hamper states' "ability to police sales to underage purchasers."[21] Moreover, of concern to the Committee and to Congress was that direct shippers of alcohol were avoiding state sales and excise tax laws: "Illegal direct shipments also deprive the state of the excise and sales tax revenue that would otherwise be generated by a regulated sale."[22] In fact, one of the key cases cited by the Committee in its report justifying the need for the Enforcement Act involved the State of Florida's allegations that an out-of-state direct shipper had failed to pay "excise taxes, sales taxes, and license fees."[23] During a hearing on a similar bill in 1997, Members of the House Judiciary Committee heard testimony from the sponsors of the legislation,[24] state officials,[25] and industry supporters.[26] Among the reasons cited for supporting the Enforcement Act, were that direct sales over the Internet, through catalogues, and other means, circumvented state sales and excise taxes. In his opening statement, Chairman Coble summed up the concern: "In recent years, improved methods of shipment and the advent of the Internet have made it possible for small wineries and breweries to reach a much broader market." He noted that "[s]tates also claim that direct shipment of alcoholic beverages to consumers deprives a state of tax revenues . . . ."[27] When the Enforcement Act was

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[19] 27 U.S.C. § 122a.

[20] H. Rept. 106-265, 106th Cong., 1st. Sess. at 5 (July 27, 1999).

[21] *Ibid.*

[22] *Ibid.*

[23] *Florida Department of Business Regulation v. Zachy's Wine and Liquor, Inc.*, 125 F.3d 1399, 1400 (1997).

[24] Rep. Robert Ehrlich, the sponsor of the legislation, testified that "Illegal interstate shipping of alcohol not only violates a state's ability to regulate incoming alcohol beverages, it also bypasses state excise taxes. The companies that obey current law and ship alcohol beverages in accordance with existing state laws pay a significant amount of money in taxes. Illegal shippers deprive states of excise and state sales tax revenue which is generated from sales of alcohol beverages. The tax revenue lost to states due to illegal shipments is estimated between $200 and $600 million a year." Statement of Representative Bob Ehrlich, Hearing on Amendment to the Webb-Kenyon Act; and The Private Property Implementation Act of 1997, Subcommittee on Courts and Intellectual Property, 1st Sess., 105th Cong. (Sept. 25, 1997).

[25] James M. Goldberg, on behalf of the Joint Committee of States, complained: "Out-of-state sellers shipping illegally into a state deprive the state of the excise tax revenue which is generated from in-state sales of beer, wine and distilled spirits, not to mention the sales tax revenue which goes uncollected from an illegal interstate sale. Statement of James M. Goldberg, Hearing on Amendment to the Webb-Kenyon Act; and The Private Property Implementation Act of 1997, Subcommittee on Courts and Intellectual Property, 1st Sess., 105th Cong., at 45 (Sept. 25, 1997) (footnote omitted).

[26] Jim Simpson, on behalf of the National Licensed Beverage Association, complained that "NLBA members have become greatly alarmed at the increasing frequency of consumers being solicited to buy beverage alcohol directly through catalogs, magazines, direct mail and the Internet." He noted that, among other problems, "[d]irect sales, in most cases, avoid State excise and sales taxes . . . ." After providing estimates of the lost state tax revenue, Mr. Simpson concluded that "[t]his hemorrhage of tax revenue will only increase as mail order, telephone, and Internet sales become more popular." Statement of Mr. Jim Simpson, Hearing on Amendment to the Webb-Kenyon Act; and The Private Property Implementation Act of 1997, Subcommittee on Courts and Intellectual Property, 1st Sess., 105th Cong., at 33 (Sept. 25, 1997).

[27] *Id at 2 & 5.*

considered by the full House, debate on the floor reflected the interest in helping states enforce their state sales and excise taxes.[28] Indeed, the Chief Senate sponsor of the Enforcement Act, Senator Hatch, noted the lost tax revenue generated by the sale of liquor from out-of-state direct shippers.[29] The record could not be any clearer that one of the primary reasons justifying the enactment of the Enforcement Act was the inability of states to enforce their rights under Webb-Kenyon to collect states sales and excise taxes from out-of-state direct shippers. That conclusion is extremely similar to the facts that gave rise to the Marketplace Fairness Act. All the elements discussed in 2000 – Internet retailers, direct shipments, and failure to collect state taxes – are all at work here, creating an uneven playing field for retailers. That is why the Webb-Kenyon and the Enforcement Act are an applicable precedent upon which to build a solution.

Conclusion

Congress could pass a one sentence statute modeled after the 1913 Webb-Kenyon Act prohibiting the direct or remote shipment of goods in violation of the tax laws of the receiving state. And, using the Enforcement Act as a guide, Congress could add several more sentences outlining the application of injunctive relief. This would provide an effective alternative solution.

Mr. Chairman and Members of the Committee, we hope this idea helps generate thought and discussion about the best way forward to solve the critical disparate tax treatment of remote and in-state sales.

I look forward to your questions.

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[28] *See e.g.*, Statement of Rep. Delahunt, 145 Cong. Rec 112, H6858 (Aug. 3, 1999) ("The bill is necessary not only to prevent illegal shipments to minors, but to enable States to police licensing standards, track sale, and collect taxes on those sales. Last year, illegal alcohol shipments cost States some $600 million in lost revenues. State taxes on alcohol are an important source of support for State programs, and protecting that funding stream is a legitimate State objective."); Statement of Rep. Sensenbrenner, *Id* at H6860 ("These illegal direct shippers are bypassing State excise and sales taxes, operating without required licenses, and most appallingly, illegally selling alcohol to underage persons." Rep. Sensenbrenner emphasized that the Enforcement Act "does not change existing State laws, and makes no restrictions on legal Internet or catalog sales. It does not open the door to Internet taxation."); Statement of Rep. Barrett, Id. at H6865 (After noting that direct sales of alcohol "drain needed tax revenue," Rep. Barrett concluded that "companies in one State should not be able to disregard the laws of another State in an effort to reach new customers.

[29] Statement of Sen. Orrin Hatch, 145 Cong. Rec. 38, S2509 (March 10, 1999).